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IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 842

A. G. HORTON AND M. K. BUCHANAN, Trading as Mechanical Ice Tray Company and I. C. E. Corporation, *Petitioners*,

v.

GENERAL MOTORS CORPORATION, *Respondents*.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioners, A. G. Horton and M. K. Buchanan, partners trading as Mechanical Ice Tray Company,[1] and I. C. E.

[1] Originally the interest of these parties was owned by Mechanical Ice Tray Corporation, a corporation of the State of Virginia, and the record and opinion are so entitled, but the interest of the Corporation was assigned to the individuals, while the case was pending in the Court of Appeals, and they were substituted for the Corporation by an order dated May 23, 1944 (R. 338).

Corporation, respectfully pray for a writ of certiorari to the Circuit Court of Appeals for the Second Circuit, to review a decree of that court of December 8, 1944 (R. 350-1). A certified transcript of the Record in the case, including the proceeding in said Circuit Court of Appeals, is furnished herewith in accordance with Rule 38 of the Rules of this Court.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

The parties to this suit entered into an agreement dated April 1, 1936 (Exh. 1, R. 144-163) under which petitioners granted to respondent an exclusive license,[2] under a group of United States patents relating to ice trays for mechanical refrigerators. The agreement provided for the payment of royalties on any device covered by any of the licensed patents (Paragraph 6(a), R. 152) and contained a provision (Paragraph Eleventh (b) printed in the margin)[3]

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[2] There was an outstanding non-exclusive license to Westinghouse, but the Court of Appeals, affirming the District Court, said: "We think this license made the defendant (respondent) an exclusive licensee though it is true that the non-exclusive license to Westinghouse remained in effect." (R. 2409)

[3] "(b) It is understood and agreed that in the event any of the claims of any of said patents are construed or held invalid by a decision of a court of competent and final jurisdiction, or by an inferior court from whose decree no appeal is taken within the time required by law, then the requirement to pay royalties under this license with respect to any such claim or claims shall be interpreted in conformity with the court's decision as to the scope or valility of such claims of said patents so that no royalty shall be payable under such claims after the date of such decision upon any ice tray which has heretofore been deemed made under said claims of any such patents and hence subject to royalties hereunder solely because they fell within the claims so held invalid or construed unless and until the Supreme Court of the United States reverses said decision, whereupon Inland shall be obligated to assume and continue the payment of royalty under such claims at and from the date of the decision of the said last-mentioned court, and the same shall apply to any claim or claims broader in scope in the elements so construed than those passed upon by the court

that in determining the requirement to pay royalties under the license the patent claims would be interpreted in conformity with any final judicial decision as to their scope or validity. Prior to April 1, 1940, in litigation against an alleged infringer, a decision was handed down (*Mechanical v. Abraham & Straus,* 31 F. Supp. 938) construing certain claims of one of the licensed patents (Patent 1,893,535).

On April 1, 1940 respondent discontinued payment of royalties on certain trays, called types 2 and 3, on which it had previously paid royalties, asserting that, under the provisions of paragraph 11 (b), any obligation to pay royalties on those devices was terminated by the judicial construction. It continued for a time to manufacture and sell and to pay royalties on a type 7 tray admitted to be within the adjudicated patent claims, but in November 1940 it began to substitute for type 7 a modified tray, called type 4, on which it paid no royalty, asserting as to type 4 also that it was relieved of obligation to pay royalties under the license by the aforesaid contract provision and judicial interpretation.

Although respondent had the right to cancel the license or surrender the exclusive license and retain a non-exclusive license (R. 156, 157) it continued to hold on to the exclusive license until after the decision of the district court in this case in the fall of 1943, thus shelving the patents during this period and preventing petitioners from practicing the inventions or from exploiting them by licensing others.

Petitioner brought suit against respondent in the Southern District of New York, alleging *inter-alia* that the introduction of the new type 4 tray superseding the patented type 7 and also the continued marketing of trays 2 and 3,

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insofar as the decision of said court shall be unfavorable to Mechanical. Nothing in this paragraph contained shall, however, be construed to relieve Inland of its obligations to pay royalties under claims not so construed, not so held invalid or that are narrower in scope as to the elements so construed than those passed upon by the court as aforesaid."

was in violation of respondent's obligation as exclusive licensee to exploit the licensed inventions for the mutual benefit of both parties and to refrain from marketing commercially equivalent devices outside the scope of the claims of the patents in competition with or in place of the licensed devices.

Respondent denied any implied obligation to exploit the licensed inventions, asserting that if any such implied obligation exists, it is void, contrary to public policy, invalid and unenforceable.

The District Court (R. 298) found that none of the trays 2, 3 or 4 was within the scope of the patent claims as judicially interpreted,[4] but held that respondent was, so long as it retained the exclusive license, under an implied obligation of good faith to exploit the licensed trays and to refrain from marketing commercially equivalent devices, outside the scope of the patent claims, in competition with or in place of the licensed devices; that respondent's type 7 tray was the commercial equivalent of its type 4 tray; that the action of respondent in making the change from type 7 tray to its type 4 tray was not attributable to any competition but solely to avoid the payment of royalties (R. 303); that respondent's substitution of the type 4 tray for the patented type 7 tray was a violation of its obligation to exploit as exclusive licensee for which petitioner was entitled to damages measured by the royalty (R. 305); but that the type 2 and type 3 trays were excluded from this implied obligation by the terms of paragraph Eleventh (b) of the license (R. 283).

The Court of Appeals by a divided court on August 26, 1944 affirmed the findings of the district court with respect to type 2 and 3 and reversed with respect to type 4 tray, thus denying petitioner all relief.

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[4] As to Reissue 18,819, to which paragraph 11(b) has no application because the reissue had not been adjudicated, the Court, affirming the district court, also held that no royalties were due on these trays because they do not have the distinguishing features of the reissue claims.

The Court recognized the existence of a well established rule imposing on an exclusive licensee an implied covenant to exploit the licensed products in good faith so as to produce royalty income. It recognized that this is not a rule limited to patent agreements but is of general application to co-adventurers, one of whom entrusts the exploitation of his property exclusively to another. The court also noted the well recognized exception that the exclusive licensee may without a breach of this obligation adopt an unlicensed (and therefore royalty free) product if it is commercially superior and its adoption is necessary to meet or anticipate competition. It found however that there were no circumstances here to bring into play this exception to the rule. It found that the licensed tray type 7 was the commercial equivalent of unlicensed trays type 2, 3 and 4 and that there was no competition to justify respondent's failure to exploit the licensed tray in good faith. Although the circumstances justifying the application of the rule of implied covenant were thus found to be present, the Court refused to give it effect because of the provisions of Paragraph Eleventh (b) of the license agreement.

The majority opinion first expresses doubt whether that part of an exclusive licensee's duty to exploit the licensed trays in good faith has survived in a practical sense the *Mercoid* case[5] and then holds that whatever may be left of the rule is not applicable in this case. The Court construed paragraph Eleventh (b) as an agreement by the parties that the exclusive licensee might make and sell whatever kinds of tray are royalty-free.

The Court said (R. 340):

> "Paragraph Eleventh (b) of the license shows that the parties contemplated that their construction of the patent claims might be narrowed by court decision and that, if they were so narrowed, devices which the defendant had made and on which it had paid running royalties could thereafter be manufactured and sold

[5] Mercoid Corp. v. Mid-Continent etc. Co., 320 U. S. 661; see also Mercoid Corp. v. Minneapolis-Honeywell etc. Co., 320 U. S. 680.

> royalty-free. The trays of type 2 and 3 were in this category. The continued manufacture, use and sale of them without payment of running royalties was, therefore, permissible in accordance with the express provisions of the license and no obligation to the contrary can be implied."
>
> * * * * * * * * *
>
> "* * * The exercise of good faith in exploiting the licensed patents did not require the defendant to refrain from doing whatever the plaintiffs had expressly agreed that it might do. No obligation not to manufacture and sell whatever kind of trays the license gave the defendant the right so to manufacture and sell can be implied and of course there can be no breach of a non-existent obligation."

This construction of paragraph Eleventh (b) as a grant by the licensee to the licensor of a "right so to manufacture" things not covered by the patent claims when the scope of those claims has been more precisely defined by judicial interpretation is the thing that gives rise to the novel question which this Court is now asked to review.

Paragraph Eleventh (b) stands in the license agreement as a continuing means of bringing the obligation of the licensee to pay royalty under the claims of the patent (expressed in paragraph Sixth (a), R. 152) always into accord with the judicially interpreted scope of the patents. Until the claims have been interpreted they stand on their terms as the definition of the things as to which the licensee must pay the licensor for the use of the monopoly. The effect of paragraph Eleventh (b) is only to make the obligation of paragraph Sixth (a) more definite when judicial interpretation has made the scope of the monopoly more definite.

When the Court of Appeals construes paragraph Eleventh (b) as a grant of right to manufacture without payment of royalty things not covered by the judicially interpreted claims, it in effect construes paragraph Sixth (a) as a grant of right to manufacture without payment of royalty things not covered by the patent claims as they stood in the unadjudicated patent.

The interpretation of either paragraph as a grant of right to manufacture unpatented things must have the effect to abrogate the implied obligation imposed on the exclusive licensee as a matter of public policy—the obligation to deal with the licensor in good faith.

Thus the Decision of the Second Circuit Court of Appeals in this case gives rise to the novel question, of general significance in the administration of the patent law, whether the implied obligation of an exclusive licensee to exploit the licensed devices in good faith and to refrain from entering into competition with them to the detriment of the licensor is abrogated by the normal provision in the license agreement that the obligation to pay royalty under the agreement is measured by the scope of the patent monopoly; and, more specifically, that the obligation of good faith is so abrogated by a provision in the license agreement that the extent of the requirement to pay royalty under the license shall conform to any final judicial interpretation of the scope and validity of the patent claims.

Because this conclusion was reached by the Court of Appeals after expressing doubt whether the heretofore recognized obligation of the exclusive license under a patent has survived in a practical sense the decision of this Court in the *Mercoid* case, the further question is raised whether this obligation of good faith is repugnant to any principle announced in that case.

JURISDICTION.

The suit is based on diversity of citizenship and an amount in controversy, exclusive of interest and costs, exceeding $3000. (Judicial Code, Section 24 (1), 28 U. S. C., Sec. 41.)

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code as amended by the Act of February 13, 1925 (28 U. S. C., Sec. 347).

The judgment your petitioners seek to have reviewed is dated December 8, 1944.

Issuance of the mandate has been stayed by order of the Circuit Court of Appeals to permit the filing of this Petition for Writ of Certiorari.

THE QUESTION INVOLVED.

1. Is the rule that an exclusive licensee is under an implied obligation to exploit the patent in good faith and not to market for its own profit, and to the detriment of the licensor, devices not covered by the patent which compete with the licensed devices (subject only to the limitation that the exclusive licensee may exploit such devices to meet adverse competition from others) waived because the agreement makes the scope of the royalty obligation co-extensive with the scope of the licensed patents?

2. Is this rule waived by a provision in the license agreement that a judicial construction of any licensed patent shall govern as between the parties as to the scope of the patent construed and the royalty obligation thereunder?

3. Is this rule repugnant to any principle announced in the *Mercoid* case?

REASONS FOR ALLOWANCE OF THE WRIT.

1. The court below refused to enforce an implied covenant of good faith that has not before been so nullified and that is of fundamental importance to the legal relationship of licensor to exclusive licensee. The court acted on grounds which in direct application make the implied covenant a nullity in any exclusive patent license. A major change in the patent law has been made on what seems a clear error going to the fundamentals of this obligation of good faith.

2. The matter is of importance to the administration of the patent law. It bears squarely on the subject of proper use of patent rights and proper dealings with respect to such rights. The existence or abrogation of this covenant heretofore implicit in exclusive licenses is sure to affect the willingness of patent owners to grant such licenses; its

abrogation will impede such licensing and, because prospective licensees frequently will take no other form of license, it will impede the process of getting inventions into use.

3. At a time when the doctrine of the *Paper Bag* case[6] is being assailed and weakened in the interest of preventing patents from being shelved, this decision enthrones the dog-in-the-manger right in an important area of patent dealings from which it has heretofore been excluded.

4. The question with respect to the *Mercoid* case in relation to this implied covenant to exploit is an important one which should be decided. The decision below creates an uncertainty in the law which should be eliminated.

5. The case was decided by a divided court and with respect to the question on which the writ is sought the dissenting opinion is in agreement with that of the district judge.

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[6] Continental Paper Bag Co. v. Eastern Paper Bag Co., 210 U. S. 405.

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GENERAL MOTORS CORPORATION, *Respondents.*

BRIEF IN SUPPORT OF PETITION.

OPINIONS OF THE COURTS BELOW.

The opinion of the District Court for the Southern District of New York is unreported but appears at pages 258 to 288 of the record. The opinion of the Second Circuit Court of Appeals appears at pages 330 to 344 of the record and is reported in 144 F. (2d) 720.

STATEMENT OF THE CASE.

The pertinent facts are sufficiently stated in the petition and will not be repeated. The pertinent portion of the majority opinion of the Court of Appeals is at pages 337 to 341 of the record (144 F. 2d 724 to 727), and the dissenting opinion of Judge Frank is at pages 341 to 343 of the record (144 F. 2d 727 to 728).

SPECIFICATION OF ERRORS.

The errors which Petitioners will urge, if the writ of certiorari is allowed, are that the Circuit Court of Appeals erred:

1. In holding that respondent was relieved of its obligation to exploit the licensed patents in good faith by paragraph Eleventh (b) of the agreement.
2. In holding that respondent's sale of unlicensed substitutes (trays type 2, 3, 4,) instead of licensed trays was not a breach of its obligation to exploit the licensed patents in good faith, entitling the petitioner to damages therefor.
3. In reversing the decree of the district court sustaining petitioner's right to damages by reason of defendant's substitution of type 4 tray for the patented type 7 tray.

SUMMARY OF ARGUMENT.

1. The Court of Appeals was clearly in error in finding an agreement that any royalty-free product could be sold without regard to the implied covenant of good faith, and in refusing to give effect to the implied covenant in the case of this licensee's royalty-free products, assuming for this purpose that the implied covenant is not repugnant to the *Mercoid* case.

2. The Court of Appeals was in error in thinking that the implied covenant is repugnant to the *Mercoid* case.

3. The abrogation of the implied covenant on either ground is a matter of general importance in the administration of the patent law, especially affecting the use of patents and the policy of the law to promote the use of inventions.

ARGUMENT.

I.

The Court of Appeals was clearly in error in finding an agreement that any royalty-free product could be sold without regard to the implied covenant of good faith, and in refusing to give effect to the implied covenant in the case of this licensee's royalty-free products, assuming for this purpose that the implied covenant is not repugnant to the *Mercoid* case.

The well established rule that an exclusive licensee is under an implied covenant to exploit the patented trays in good faith, and to refrain from entering into competition with the patented device for its own profit and to the detriment of the licensor, is recognized by the Court of Appeals (R. 337-40; 144 F. (2d) 724-6). Its statement shows that the rule is one of general application to all situations involving co-adventurers.

> "The second cause of action is based on the duty of an exclusive licensee on the unit royalty basis to exploit in good faith and its alleged breach. The theory of that cause of action is that the productiveness of the licensor's property having been placed solely within the control of the licensee, a covenant on its part to work the patent in good faith to make it produce royalty income will be implied.
>
> "The principle is well established with respect to a wide variety of contracts in which the consideration for a grant of property lies wholly in the payment of 'sums of money based upon the earnings of the property transferred.' *In re Waterson, Berlin & Snyder Co.*, 2 Cir., 48 F. (2) 704, 709. It has been applied in the case of such diverse transactions as the granting of the exclusive right to place the licensor's endorsement of approval on the dress designs of others (*Wood* v. *Lucy, Lady Duff-Gordon*, 222 N. Y. 88, 118 N. E. 214), to quarry stone (*Stoddard* v. *Illinois Improvement Ballast Co.*, 275 Ill. 199, 113 N. E. 913), *Ellis* v. *Swan*, 38 R. I. 534, 96 Atl. 840), to sink and operate oil wells (*Harris* v. *Ohio Oil Co.*, 57 Ohio St. 118, 48 N. E. 502), to trans-

port cargoes (*Great Lakes & St. Lawrence Transportation Co.* v. *Scranton Coal Co.*, 7 Cir. 239 F. 603), to mine gold (*Pritchard* v. *McLeod*, 9 Cir., 205 F. 24), and to exploit a musical composition (*In re Waterson, Berlin & Snyder Co., supra*). And see, *Dwight & Lloyd Sintering Co.* v. *American Ore Reclamation Co.*, D. C. 44 F. Supp. 391. It has been held that such a contract includes an implied negative covenant that 'neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract.' *Uproar Co.* v. *National Broadcasting Co.*, 1 Cir., 81 F. (2d) 373, 377, cert. den. 298 U. S. 670.

"In a number of cases an express covenant to exploit a patent has been enforced against an exclusive licensee. See *Neenan* v. *Otis Elevator Co.*, 2 Cir., 194 F. 414; *Crowe* v. *Oscar Barnett Foundry Co.*, D. C. 213 F. 864, modified 3 Cir., 219 F. 450; *Carbo-Frost, Inc.* v. *Pure Carbonic Inc.*, 8 Cir., 103 F. (2) 210, cert. den. 308 U. S. 569; *Matzka Corp.* v. *Kelly Dry-Pure Juice Corp.*, 19 Del. Ch. 359, 168 Atl. 70; *DeStubner* v. *Microid Process, Inc.*, 121 W. Va. 773, 6 S. E. (2) 777.

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"There is one well recognized exception to the doctrine as it has previously been applied. That is where there is outside competition which the exclusive licensee cannot meet with reasonable chance of success with the licensed article. *Eclipse Bicycle Co.* v. *Farrow*, 199 U. S. 581; *Carbo-Frost, Inc., supra; Briggs* v. *United Shoe Machinery Corp.*, 92 N. J. Eq. 277, 114 Atl. 538. If such competition comes from something not commercially better than the licensed device he must meet it by means of the latter. If he sees fit to overcome the competition by purchasing the right to make the completing article, he cannot substitute the latter for the licensed device without thereby violating his covenant to exploit so long as he retains an exclusive license. But if the competition comes from a better article than the one licensed, he is under no obligation to try with no hope of success to meet it with the licensed device. Compare, *Parev Products* v. *I. Rokeach & Sons*, 2 Cir., 124 F. (2) 147. Faced with such a business situation he may, if he can, obtain and exercise the right to make

> or use the competing article without violating any obligation to exploit under his exclusive license. *Eclipse Bicycle Co.* v. *Farrow, supra; Carbo-Frost Inc.* v. *Pure Carbonic, Inc., supra.*"

In the case of *Underhill* v. *Schenck,* 238 N. Y. 7, Judge Cardozo of the New York Circuit Court of Appeals stated the proposition in these words (p. 13):

> "This fiduciary relation charged the fiduciary with a duty to refrain from forms of competition involving unfair diversion of royalties or profits. The position of such a one is analogous in this respect to the position of a partner. What he gains from a competing business, if the competition is so close as to transcend the bounds of fairness, he is not to keep for himself, but is to surrender to the joint adventure (*Trimble* v. *Goldberg,* 1906, A. C. 494, 500; *Aas* v. *Benham,* 1891, 2 Ch. D. 244, 255; *Latta* v. *Kilburn,* 150 U. S. 524, 549; *Beatty* v. *Guggenheim Exploration Co.,* 225 N. Y. 380, 386; cf. *Cescinsky* v. *Routledge & Sons, Ltd.,* 1916, 2 K. B. 325)."

The one fact which illuminates the purpose of the implied covenant is that we are dealing with an exclusive license. The presently significant incident of such a license is that it excludes the licensor himself both from the practice of the invention and from any opportunity to exploit the invention by licensing others. That exclusiveness, so valuable to the license while he is establishing his business, contains the possibility that the licensee will play "dog in the manger" after he has become established and will turn to some unlicensed substitute evolved in the meantime which is no better than the patented thing but is capable of replacing it in the market. In that event, the licensee would keep his exclusive position, and extend it even to the exclusion of his licensor, without paying any royalty. That possibility—here the reality—creates the need for the covenant to exploit, with its implementing obligation to compensate the licensor if the licensee fails to do so while still exclud-

ing the licensor from his opportunity to exploit otherwise.[6a]

Primarily the covenant is an affirmative one to exploit the patented thing and a negative covenant that the licensee will not sell unlicensed substitutes—which would deprive th elicensor of royalty—unless such sale is justified by a competitive necessity. That justification for selling a royalty-free product arises when a competitor puts out a superior product with which the patented product would not successfully compete. But the licensee is not limited to that justification; he may anticipate competition and advance his interest and that of the public by changing to a non-infringing product superior to the patented one. The principle and its limitation therefore protect both parties and the public. All it imposes on the licensee is an obligation not to sell products that are commercially equivalent to the patented product or, in other words, products that are no better in competition but merely different in ways that avoid the licensed patents and the royalty obligation, and the sale of which would have only the effect of cutting off the licensor's income while leaving him powerless to exploit the patented thing himself or through others.

The incident of this covenant that is of primary significance is the sanction by which it is made effective. That is an award of damages for its breach. Such damage may be measured by the royalty of which the licensor was deprived by the breach. It is to be mistaken by appearances however if one views this as a royalty on unpatented products or as an enforcement of a monopoly of them. It is altogether the enforcement of an obligation of decency which protects the

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[6a] Here the exclusive licensee had the right to surrender the exclusive license, retaining a non-exclusive license. If upon its decision to promote unlicensed trays instead of the licensed trays, respondent had surrendered its exclusive license, petitioner would have had no claim. The gravamen of the complaint is that while promoting unlicensed trays respondent still retained its exclusive license, thus preventing licensor or any one else from exploiting the licensed patents (R. 156).

licensor without adversely affecting any proper interest of the licensee or of the public.

The other chief incident of this covenant is that in all dealings between licensor and licensee it introduces a second and largely independent inquiry in the settlement of an account between them; second, that is, because the primary inquiry is posed by the express obligation to pay a royalty on all patented products sold. The second inquiry, invoking this implied covenant, arises *only* if on the first inquiry it is found that the licensee has sold a product that is not within the patent and is therefore royalty free.

The important facts to be observed are these: (1) the question of patent scope relates primarily to the first inquiry fixing the royalty obligation; (2) the second inquiry involves only a question of relative marketability, competitive justification.

The second inquiry arises only if the first reveals the sale by the exclusive licensee of an unlicensed and therefore royalty-free product. Hence, any resort to the implied covenant presupposes the sale of a product which is royalty free.

How the fact of freedom from royalty is established is immaterial—whether by agreement, by compromise, by arbitration, by litigation or by reference to some decision against a third party that is taken as definitive. Hence, in this case, paragraph "Eleventh (b)" to the extent that it applies, figures simply as one way of disposing of the first inquiry; it has nothing to do with the second. The failure to perceive the difference between these two inquiries is the root of the court's error below.

The Court of Appeals gave paragraph Eleventh (b) an effect beyond that of determining what is within or without the patent and so within or without the *royalty obligation.* It assumed that because paragraph Eleventh (b) made the trays royalty free with respect to the adjudicated patent, the parties must have impliedly agreed that the licensee could make and sell these trays, even though such conduct

would otherwise involve a breach of the *implied obligation* of good faith.[7] But to imply a freedom to make and sell from the fact that the product is free of the express royalty obligation is to abrogate the implied covenant to exploit. For it is not until it is made to appear that under the agreement the products sold by the exclusive licensee are royalty free that there is any need to invoke the covenant. It is because they are royalty free that the law imposes the implied obligation of good faith. To make the very fact which gives rise to the covenant the basis for denying it, is to abrogate the rule itself.

On this point, Judge Frank, in his dissenting opinion said (R. 342-3):

> "I do not believe that, when the parties agreed upon clause 11, they had any such result in mind, that they meant that defendant could thus, in part, place plaintiff's patent on ice. In other words, I do not believe that they intended that, should a court decision narrow the patent claims in any respect, the defendant, still retaining its right to keep plaintiff from using the patent, could itself reduce the sales of the patented device while making and selling a competing article which it had not therefore made and which no one else was making or selling or threatening to make or to sell. Nor can I agree that, on any principle of fairness or public policy, we should, without regard to the parties' actual intention read into the contract a 'constructive' intention to permit such anti-social conduct, which, I think, closely approaches (if, indeed, it does not reach) illegality."

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[7] The Court seems to have applied the same reasoning with respect to the reissue patent to which paragraph Eleventh (b) does not apply. This emphasizes that paragraph Eleventh (b) does not alter the nature of the implied obligation or differentiate this exclusive license from any other exclusive license to which the rule of implied covenant has been applied.

II.

The Court of Appeals was in error in thinking that the implied covenant is repugnant to the *Mercoid* case.

The doctrine of the *Mercoid* case is that a patent owner may not use his patent to restrain or control the use or sale of an unpatented article whether by conditions imposed upon his licensees or otherwise. In that case the patent covered a heating system as a combination. Licenses to install and use that system could only be secured by purchasing a control (an element of the patented combination) from a licensee, and the royalty to be paid by the licensees manufacturing the control was based on the sales price of the unpatented control. Thus the patent on the system was used to obtain a monopoly of the use and sale of the unpatented control and the fact that the royalty was based on the control emphasized that that was the aim.

The covenant to exploit is not repugnant to this doctrine. It does not secure a monopoly of unpatented things. Anyone other than the exclusive licensee is free to make, use or sell a non-infringing substitute for the patented article. And even the exclusive licensee is not prevented from doing so, although under certain carefully defined and limited conditions he may be held answerable in damages to the patent owner if he does. The defined and limited conditions are that if the exclusive licensee adopts a royalty free substitute merely to avoid royalty payments and without any justification in the competitive situation he must pay damages measured by the royalty. Moreover, in this case, and in most cases, the exclusive licensee is given the option of relinquishing his exclusive license and when he does so he becomes freed even of the damage liability.

The damage liability does not arise because a patent license is involved. The rule of implied covenant is one applicable to property rights in general. It is based on principles of good faith and fair dealing. Wherever a party has been entrusted by another with the sole control of the

productiveness of any property the law imposes upon him an affirmative obligation to exploit that property in good faith and if he breaches that obligation he will be held in damages. The key of the matter is that the exclusive grantee has sole control of the enterprise. Having been placed in a position of trust the law holds him answerable for any abuse of that trust. It is unreal to think of the damages for a breach of this trust as a payment of royalty on unpatented devices. It is not that in fact. The covenant merely protects the patent owner by subjecting the licensee to a penalty if he fails to exploit the patented product. Absent such a covenant, the exclusive license is free to abuse his power of control, suppress at will the licensed patents and thus to undermine the public policy stated to be at the basis of the *Mercoid* case. This is pointed out by Judge Frank in his dissenting opinion (R. 343-4; 144 F. (2d) 728):

> "And, cutting across the Paper Bag rule, the courts developed the doctrine of the obligation of an exclusive licensee not to deprive the public of the benefit of the patent. As this latter doctrine promotes the public interest, it is surprising that the defendant should urge that it is inconsistent with, and should be abandoned because of, such recent cases as *Sola Electric Company* v. *Jefferson Electric Company*, 317 U. S. 173, or *Mercoid Corporation* v. *Midcontinent Investment Company*, 320 U. S. 661, or *Nachman Spring-Filled Corporation* v. *Kay Manufacturing Corporation*, 139 F. (2d) 781 (C. C. A. 2), and should quote in favor of its position this statement from the *Mercoid* case: 'The patent is a privilege but it is a privilege which is conditioned by a public purpose.' The decisions cited by defendant, which stress the limited constitutional basis for congressional authorization of patent monopolies, have insisted that patent rights should not be utilized to repress competition unduly. Yet defendant here asserts, with my colleagues' approval, that it may employ its license to reduce competition between types 4 and 7, thereby barring the public from receiving the advantages of the exploitation of plaintiff's patent."

III.

The abrogation of the implied covenant on either ground is a matter of importance in the general administration of the patent law, especially affecting the use of patents and the policy of the law to promote the use of inventions.

The court acted on grounds which make the implied covenant a nullity, and its view of the relationship of this covenant to the *Mercoid* case casts doubt on the legality of the covenant. The uncertainty as to the enforceability of the covenant which the decision creates will affect the willingness of patent owners to grant exclusive licensees, and because prospective licensees frequently will take no other form of license, it will impede the process of getting inventions into use.

The importance of exclusive licenses in encouraging the introduction and extensive use of inventions has recently been given governmental recognition. The Department of Agriculture in a recently issued Patent Manual (Miscellaneous Publication No. 551—U. S. Dept. of Agriculture), referring to the fact that the Secretary has only the power to issue non-exclusive licenses under patents assigned to him, says:

> "It has been found that the nonexclusive feature prevents extensive use of the invention. The marketing of an invention so that it can be used is as important as the making of the invention itself. A recent survey has shown that where a substantial amount of capital is involved in marketing an invention, a manufacturer will be reluctant to invest capital for that purpose unless he is given some measure of protection against competition. This could be done by granting exclusive rights, which the Secretary is not now authorized to do. The enactment of legislation has been advocated that would permit the issuance of exclusive licenses under Government patents for periods long enough to protect invested captial, so that such patents will not become dormant for lack of commercial exploitation."
> (page 14, footnote)

Impairment of this beneficient rule of good faith and fair dealing has another harmful effect. The rule had created one area in the patent law within which, despite the *Paper Bag* case, a patented device could not be shelved. Now a patent license clause commonly employed for a legitimate purpose and which does not affect the fundamental relationship of the parties is so applied as to overthrow the rule of common decency and enthrone the dog in the manger rule of the *Paper Bag* case even between an exclusive licensee and his licensor. The result is that at the exclusive licensee's whim the public may be debarred from receiving the advantage of licensor's patent and the licensor is deprived of his reward, while the licensee continues to profit at the expense of both.

A major change in patent law has been made on what seems a clear error going to the fundamentals of the obligation of good faith.

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FEB 3 1945
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CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944

No. 844

A. G. HORTON and M. K. BUCHANAN, Trading as MECHANICAL ICE TRAY COMPANY, and I. C. E. CORPORATION,

Petitioners,

v.

GENERAL MOTORS CORPORATION,

Respondent.

BRIEF FOR RESPONDENT

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BRIEF FOR RESPONDENT

Statement

The petition and supporting brief which have been filed in this case present an entirely unrealistic and incorrect picture of what the issues were in the lower court and how they came about. A brief statement is therefore presented.

The complaint (which was filed on September 26, 1941, (R. 4-6) as limited by the Bill of Particulars as amended (R. 7, 14, 19) originally asserted a single cause of action for the breach of the license agreement of April 1, 1936 (Exh. 1, R. 144-163), because of the alleged failure by respondent, since April 1, 1940, to pay royalties under Paragraph "Sixth" (a) of the agreement (R. 152) with respect to certain *ice trays, for use in electrical refrigerators,* designated as types 2, 3 and 4, claimed to come within the scope

of claims 13 and 17 of licensed patent No. 1,893,535 and claims 8, 9[1] and 14 of licensed reissue patent No. 18,819.[2] The answer denied the allegations of breach and set forth, affirmatively, that the specified claims were limited in scope so as to exclude the accused trays because of file wrapper estoppels (Answer 8, R. 9-10, as amended,[3] R. 15), because of the prior art (Answer 11, R. 12) and by virtue of the application of the provisions of paragraph "Eleventh" (b) of the agreement in view of the limitation placed by Judge Campbell on claims 13 and 17 of patent No. 1,893,535 in his decision of March 8, 1940 (Exh. R)[4] in an action brought in the District Court for the Eastern District of New York and entitled Mechanical Ice Tray Corporation, plaintiff, vs. Abraham Straus, Inc. (Answer 9, R. 10-11 as amended R. 15-16). The answer further alleged that because of such prior decision and the provisions of paragraph "Eleventh" (b), the petitioners were estopped from asserting that the claims in suit of reissue 18,819 embraced or covered the accused trays (Answer 10, R. 11-12).

On the eve of trial in June, 1943 (R. 2), the petitioners in a trial brief and a memorandum of so-called excerpts from cases (copies of which respondent did not see until after the trial began), asserted for the first time a new claim for relief, i. e., the existence, and breach of, implied obliga-

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[1] This claim was added at the trial (R. 271).

[2] The claims of another licensed patent—Reissue No. 21,800—were in issue below but plaintiff has withdrawn the same and no evidence relating thereto has been included in the record, but Findings of Fact Nos. 5[c], 11, 20-22 (R. 293, 295-296, 298-299) and Conclusions of Law, Nos. III, IV (R. 303) were made with respect thereto.

[3] The amendment referred to here and those immediately following were necessary due to the change from claim 18 of patent No. 1,893,535 in the original Bill of Particulars to claim 17 in the amended Bill (R. 19).

[4] This decision (Exh. R) has not been printed in the record by stipulation of the parties (R. 324). It is reported in 31 F. Supp. 938.

tions on respondent to exploit the licensed patents and to refrain from making commercially equivalent devices not covered by the claims. When subsequently pressed at the end of the trial, and on their argument, to state specifically their exact position (see opinion, R. 259-260), the petitioners in an answering and final brief moved "for leave to amend the complaint to conform to the evidence" (see opinion, R. 260). Thereafter the District Judge (Leibell) filed his opinion on September 13, 1943, in which he allowed their motion as follows (R. 260):

> "I shall grant plaintiffs' motion for leave to amend the complaint by pleading a further claim based on an implied obligation on defendant's part to exploit plaintiffs' patents; defendant's attempt to evade that obligation by the manufacture of the *type 4* [1] tray in October, 1940, as a substitute for the type 7 tray; defendant's failure to pay plaintiffs any royalties on the type 4 tray; and plaintiffs' damage resulting from defendant's said conduct."

The judge below then went on to determine the existence and breach of the obligations as he set them forth in the above quotation. On September 25, 1943, petitioners filed their Amendment to the Complaint (R. 20) expressly embodying the substance of the foregoing language of Judge Leibell but *restricting* the alleged breach by the manufacture and sale of type 4 tray as follows:

> "Defendant has breached this implied obligation by adopting commercially equivalent devices, *in particular by substituting its type 4 tray for its type 7 tray*, and by its refusal to pay royalty on such devices."

Thereafter on October 4, 1943, respondent filed an amendment to the answer denying the allegations of the amend-

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[1] Unless otherwise specified, emphasis and matter in brackets in quotations are mine.

ment to the complaint and affirmatively alleging that any such implied obligation was void, contrary to public policy, invalid and unenforceable (R. 22).

On the case as finally presented for decision the courts below had before them (1) the issue of the scope, and infringement by types 2, 3 and 4 trays, upon the claims in suit of patent No. 1,893,535 and of reissue patent No. 18,819 and (2) the issue of the construction of the agreement of April 1, 1936 and specifically the construction of paragraph "Eleventh" (b) thereof coupled with Judge Campbell's decision in the prior Abraham & Straus case with respect to the existence and breach of the asserted implied obligations.

The first issue—whether types 2, 3 and 4 were embraced by the claims of the asserted patents—was decided against the petitioner by concurrent findings and holdings of both of the courts below (R. 294-295, 296-298, 303; 334-337) and is not involved in the petition pending before this Court in this case.

The second issue, involving as it did, whether or not there was any implied obligation, was decided by both courts below in this fashion:

1. Both courts held the implied obligations to have existed (R. 304 and 337-339).

2. Both courts agreed in their holdings that paragraph "Eleventh" (b) of the agreement and Judge Compbell's decision of March 8, 1940 which limited claims within the purview of "Eleventh" (b) (R. 283, 294, 336-337) were, in effect, express limitations on the implied obligations. Said the District Court (R. 283-284):

> "If Judge Campbell's decision freed any of the devices then being made by defendant from the dominance of the plaintiffs' patents, defendant could stop paying royalties thereon. After that decision defendant could

have made the Crosley [1] device, with Crosley's consent, of course. The purpose of Clause XI (b) was to put the defendant on the same footing as any other manufacturer of ice trays, in so far as a court's decision might *limit* or hold invalid any claim of a patent covered by the license agreement."

The Court of Appeals put its holding in this fashion (p. 340):

"Paragraph Eleventh (b) of the license shows that the parties contemplated that their construction of the patent claims might be narrowed [2] by court decision and that, if they were so narrowed, devices which the defendant had made and on which it had paid running royalties could thereafter be manufactured and sold royalty-free. The trays of type 2 and 3 were in this category. The continued manufacture, use and sale of them without payment of running royalties was, therefore, permissible in accordance with the express provisions of the license and no obligation to the contrary can be implied.

* * * * *

"Assuming, arguendo, that there was an implied covenant not to compete with the licensed trays except to meet outside competition this manufacture and sale of the type 4 tray was not a breach of it provided the parties had agreed that the defendant might make and sell that tray royalty free. The exercise of good faith in exploiting the licensed patents did not require the defendant to refrain from doing whatever the plaintiffs had expressly agreed that it might do. No obligation not to manufacture and sell whatever kind of trays the license gave the defendant the right so to manufacture and sell can be implied and of course there can be no breach of a non-existent obligation."

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[1] This was the ice tray involved in Judge Campbell's decision in the Abraham & Straus case.

[2] The Court of Appeals had previously found, as had also the District Court, that Judge Campbell's decision in the Abraham & Straus case had narrowed the claims (R. 275, 336-337).

And even Judge Frank of the Court of Appeals, who purportedly dissented, agreed in principle with the foregoing holdings (R. 341-342):

> "Clause 11 of the agreement, coupled with the decision of Judge Campbell in the *Abraham & Straus* case, put defendant in the position it would have occupied if the agreement had provided that types 2 and 3 were not within the patent claims and that defendant could continue, free of royalties, to make and sell them. It was as if originally the parties had expressly agreed that, although defendant was required to exploit the patent, it was not required to discontinue making and selling types 2 and 3, despite the fact that they competed in part with the patented device."

3. The District Court held that the making and selling of types 2 and 3 which defendant had been making prior to the decision of March 8, 1940 by Judge Campbell in the Abraham & Straus case was not a breach of the implied obligations after said decision because of the express provision of "Eleventh" (b) (R. 283) and dismissed the complaint as to these types 2 and 3. However, although finding that type 4 was the mechanical equivalent of types 2 and 3 (R. 297, 302), the District Court, on a theory of "commercial" equivalency to a type 7 (R. 303) which had been put out with royalties paid thereon, concluded that the manufacture and sale of type 4 (since it began to be made after the Abraham & Straus decision and in substitution for type 7) was a breach of the implied obligations (R. 304). The majority of the Court of Appeals took into consideration *all* of the findings of the District Court and held that the latter conclusion was wrong, saying (R. 340-341):

> "Although the type 4 tray was correctly found to be a modification of the type 7 tray, it was in fact also no more than a modification of the type 2 and type 3 trays. The court found that 'Type 4 embodies the moveable transverse sections of types 2 and 3 and the two-part structure of the longitudinal member of the grid of type 3. In structure and mode of operation to

effect the release of ice blocks from the grid it is quite similar to types 2 and 3'.[1] The similarity in operation just mentioned is so close that it is identical. The only mechanical difference is that already mentioned which is the attachment of the lever of type 4 to the grid near one end instead of nearer the center as in the 2 and 3 types. Mechanically the three types, 2, 3 and 4 are equivalent.

"There was no covenant, express or implied, limiting the number of types 2 and 3 trays which the defendant could manufacture and sell after the *Abraham & Straus* decision. As type 4 was *mechanically, structurally, and commercially the equivalent of types 2 and 3* the manufacture and sale of it was included in the permission to manufacture and sell such trays without limitation.

"It should be noticed that the defendant is not charged with having failed to manufacture and sell any trays under the license after the *Abraham & Straus* decision. The record shows that it did continue to sell type 7 trays and sold 1,440,000 on which it paid royalties between April 1, 1940 and December 1, 1942.[2] The second cause of action was therefore not proved and the judgment thereon must be reversed."

As mentioned above, Judge Frank agreed with the majority, as did the District Judge, as to the interpretation of the agreement in suit and particularly paragraph "Eleventh" (b). The extent of the application of that interpretation is the only real point of difference between the majority and Judge Frank. All the judges below agreed that "Eleventh" (b) coupled with the decision in the Abraham & Straus case did in fact limit the asserted implied obligation to the extent that the manufacture and sale of types 2 and 3 were not a breach of any obligation express or implied in the agreement in suit.

The foregoing issues outlined above were not only presented by the pleadings but were expressly argued to the

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[1] Finding 34 (R. 302). See also Finding 13 (R. 297).

[2] Finding 36 (R. 302).

courts below; that is to say, plaintiffs themselves fashioned the issue which has been decided against them. Mr. Davis, who is of counsel on the petition presented here, conceded and posed the issue on the trial in the District Court as follows:

1. Respondent could have, after the Abraham & Straus decision, made and sold the Crosley device (involved in that prior suit) without protest from plaintiffs,

> "* * * because Paragraph Eleventh in the agreement expressly provided that" (R. 138).

2. "I agree with you that this decision [the Abraham & Straus decision] and the rights arising under the contract, paragraph eleventh, are the nub of the thing—" (R. 138).

3. "I say that paragraph [Eleventh (b)] is in the contract and it is binding on the parties. If this device that they are now making lies within the things excluded from the payment of royalty by that specific paragraph eleventh, then they don't have to pay royalty in spite of this obligation [to exploit and to refrain from making a commercial equivalent], because I agree with you, to that extent the obligation was defined" (R. 140-141).

4. "I think if you hold that Judge Campbell in his construction of the patent excludes these devices of the defendant, that they are freed from royalty. I just don't think he did. That is where we differ factually" (R. 142).

5. "I say quite frankly to you * * * Paragraph Eleventh, so far as it operates or whenever it operates, *limits this general obligation* [good faith, to exploit, etc.] that *is implicit in the transaction.*

"The Court: Because this is an agreement made by the parties themselves to govern their relationship.

"Mr. Davis: Defining that obligation. So I said to you this morning and it results in the same conclusion we came to this afternoon, that if Judge Campbell's interpretation of the patent excludes these de-

vices, then Paragraph Eleventh by contract voids the necessity of paying royalties. We all agree on that" (R. 142-143).

6. "It is an obligation of good faith, and if the licensee violates that obligation then the remedy is not to say that the devices that he makes are inside the patent or any artificiality like that, but the remedy is a suit for damages for neglecting the obligation, the measure of the damages is the royalty rate, and so the courts just jump to the conclusion that he is obliged to pay as though the things were within the patent. Now that is the general obligation. But I say again, so there won't be any misunderstanding, that in *this contract Paragraph Eleventh is an expressed limitation of that obligation*" (R. 143).

Against the foregoing recital of background of the case and the issues raised and decided by the courts below, the artificiality of the asserted questions here sought to be raised for review (Pet. 8) and, in fact, of the entire petition, is almost too apparent for extended argument.

Summary of Argument

I. None of the three questions asserted to be involved (Pet. 8) has any real basis in any issue decided adversely to petitioners.

II. No major change in the patent law nor any matter of importance to the administration of the patent law is involved.

III. The petition is in fact baldly misleading in several respects.

Argument

I

a. The first question stated to be involved states the rule of the asserted implied obligation on an exclusive licensee and asks if such rule is "waived because the

agreement makes the scope of the royalty obligation co-extensive with the scope of the licensed patents." The decisions below will be searched in vain for any holding or even discussion one way or another that the agreement involved makes the "scope of the royalty obligation co-extensive with the scope of the licensed patents." The statement of the case made above shows such an issue was, and is, entirely immaterial to any ground or basis of the decisions of the Circuit Court of Appeals. Further, the petitioners themselves put the issue, in effect, to the courts below thus: Paragraph "Eleventh" (b) is a limitation on the implied obligation if the prior Abraham & Straus decision narrowed the scope of the claims; and, if the devices respondent is now making are excluded by virtue of said paragraph and decision, respondent is free of all liability. Where petitioners actually took issue in the courts below was on the proposition that the Abraham & Straus decision did not limit or narrow the claims. On this proposition both courts below (including the dissenting judge), found against the petitioners, the divergence being only the extent of the application of the unanimous interpretation of the agreement coupled with the prior decision.

Whether the "scope of the royalty obligation" is or is not "co-extensive with the scope of the licensed patents" is an entirely immaterial and abstract proposition to any issue decided adversely to petitioners in the courts below.

b. The second question (Pet. 8) can be said to have some relation to the issues of the case, but this question is cast in an artificial and misleading form in an attempt, it is supposed, to give the allegedly "basic" issue more importance than it deserves. Neither of the courts below held that the "rule" was (or was not) "waived by a provision in the license agreement that a judicial construction of any licensed patent shall govern as between the

parties as to the scope of the patent construed and the royalty obligation thereunder." No such issue in this form was presented by petitioners or respondent to either court under their pleadings or by their counsels' arguments, and neither court below decided any such issue. In fact, the District Court expressly (R. 283-284) and the Court of Appeals by clear implication (R. 340) placed their respective interpretations of "Eleventh" (b) and the Abraham & Straus decision squarely within the rule's exception—the meeting of outside competition without liability.

> "The purpose of Clause XI (b) was to put the defendant on the same footing as any other manufacturer of ice trays, in so far as a court's decision might limit or hold invalid any claim of a patent covered by the license agreement" (District Judge Leibell, R. 283-284).

> "The continued manufacture, use and sale of them without payment of running royalties was, therefore, permissible in accordance with the express provisions of the license and no obligation to the contrary can be implied" (Circuit Judges Chase and A. N. Hand, R. 340).

> "Clause 11 * * *, coupled with the decision of Judge Campbell * * *, put defendant in the position it would have occupied if the agreement had provided that types 2 and 3 were not within the patent claims and that defendant could continue, free of royalties, to make and sell them. It was as if originally the parties had expressly agreed that, although defendant was required to exploit the patent, it was not required to discontinue making and selling types 2 and 3, despite the fact that they competed in part with the patented device" (Judge Frank, R. 341-342).

Any decision which so limited the claims to exclude respondent's devices would free other (and unlicensed) manufacturers to make devices identical to, and in competition with, respondent's without the necessity of paying royalties or other tribute. The existence of potential outside competition because of a limitation placed on broad claims of a licensed patent is well within the conceded exception of freeing respondent of liability and this was embodied in Paragraph "Eleventh" (b) of the agreement in suit.

Petitioners in their petition and brief now attempt to divorce the "implied obligation" of good faith, etc., from the express terms of the agreement. They now argue that once one becomes an exclusive licensee he should pay one way or another on anything he makes or sells without reference to the provision of the instrument creating the license, except (in their view) to actual and proven pressure of outside competition. Analogy is made to a trust relationship. However, this Court is entirely familiar with the fact that express provisions of a trust instrument will often prevent the imposition on the trustee of obligations implied in law in the absence of express clauses. For example, a trustee can only invest with impunity in "legal" investments, but where he is expressly empowered to invest in "non-legal" securities, he may do so without liability. So also a trustee may be exempted expressly from liability for ordinary negligence in investing trust funds, being, however, liable in the absence of such express exemption.

The asserted implied obligations cannot therefore be considered in the abstract and apart from the provisions of the agreement in suit. Petitioners recognized in the courts below that these implied obligations were part and parcel of the agreement and should be considered—as both courts did—subject, and in relation, to the express provisions of that contract.

The second question, like the first, does not, therefore, raise any question which was in reality presented and involved in the courts below.

c. The third question about repugnancy to the *Mercoid* case was definitely placed outside the decision of the Circuit Court of Appeals where it said (R. 339):

> "Although the defendant has argued with much force that public policy no longer permits an exclusive licensee to be so restricted in action a majority of the court does not believe decision on that point is necessary on this appeal."

The court then went on to assume an implied covenant not to compete (R. 340) but held that by virtue of "Eleventh" (b) and the decision narrowing the claims, the parties had expressly agreed that respondent was free of liability.

II

From all that has been set forth above, it is clear that there was no major change in the patent law or matter of importance to its administration involved in the decisions below (cf. Pet. 8). The case is simply one of a construction of a contract between two parties involving a particularly limited situation. The construction adopted by the courts below and the extent of the application of that construction by the Court of Appeals in no way conflicts with any general rule of law but is in conformity with the general rule that where the express provisions of a contract conflict with what otherwise would be implied, the former controls.

A decision on the demonstrated abstractness and unreality of petitioners' propositions and questions would serve no useful purpose as a guide for future litigation or conduct of parties.

III

To illustrate the length which petitioners' counsel have gone in unfair innuendoes and misleading statements concerning this case in an attempt to persuade this Court to grant their petition, the following (in addition to what has been stated above) is an excellent example.

The petition states (Pet. 4):

> "The Court of Appeals *by a divided court* on August 26, 1944 affirmed the findings of the district court with respect to type 2 and 3 and reversed with respect to type 4 tray, thus denying petitioner all relief."

Among the reasons stated for allowing the writ, is this one (Pet. 9):

> "5. The case was decided by a divided court and with respect to the question on which the writ is sought the dissenting opinion is in agreement with that of the district judge."

In their argument in support of the petition it is asserted (Pet. 18):

> "But to imply a freedom to make and sell from the fact that the product is free of the express royalty obligation is to abrogate the implied covenant to exploit. For it is not until it is made to appear that under the agreement the products sold by the exclusive licensee are royalty free that there is any need to invoke the covenant. It is because they are royalty free that the law imposes the implied obligation of good faith. To make the very fact which gives rise to the covenant the basis for denying it, is to abrogate the rule itself."

This argument is followed by a partial quotation from Judge Frank's opinion purportedly in support of the argument.

The thread of thought which petitioners seek to weave into this Court's mind is that there was some real divergence in interpretation of paragraph "Eleventh" (b) coupled with the prior decision between the majority of the Circuit Court on the one hand and Judge Frank and the District Judge on the other hand. Such is not the case. All the judges in both courts below were one in their opinion that

1. There were implied obligations originally.

2. Paragraph "Eleventh" (b) coupled with a decision narrowing claims was a limitation on the implied obligations.

3. That respondent was free to make and sell types 2 and 3 without liability to petitioners by virtue of "Eleventh" (b) coupled with the Abraham & Straus decision.

The division was on a very narrow ground and that was the extent of the application of "Eleventh" (b) to a particular fact situation, *i. e.*, to the manufacture and sale of the type 4 tray which was, in fact, the mechanical equivalent of both types 2 and 3 established by all the Judges in both District and Circuit courts as excluded from royalty.

There was thus no division in principle or inherent interpretation of the agreement.

For the petitioners to say, in reason 5, that "*with respect to the question* on which the writ is sought the dissenting opinion is in agreement with that of the district judge" is absolutely untrue, since, under their question (for example, questions 1 and 2) and their whole petition and brief, they seek a review of the holdings below as to types 2 and 3 as well as type 4. It is true that Judge Frank and the District Judge were in agreement that the sale of types 2 and 3 did not breach the

implied obligation, but that type 4 (erroneously in respondent's view) did. However, the petitioners also seek to overthrow the views of both Judge Frank and the District Judge[1] while attempting to rely, for example, on a partial quotation from Judge Frank's opinion. Reason No. 5 (Pet. 9), by its inherent fallacy, further exposes the entire artificiality of the questions and reasons advanced by this petition.

Conclusion

It is submitted that the petition is without sound basis, and should be denied.

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Counsel for Respondent.

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[1] Specification of Errors numbered 2 (Pet. 12) shows their intent clearly.